

# CITY OF NEWPORT NEWS

## OFFICE OF THE CITY MANAGER

March 22, 2011

**TO:** The Honorable City Council  
**FROM:** City Manager  
**SUBJECT:** Recommended FY 2012 Operating Budget

I am transmitting for your consideration my recommended operating budget for the fiscal year that begins July 1, 2011 and ends June 30, 2012. I look forward to working with you in the coming weeks to successfully complete the budget process.

This community, as most others in this country, has now gone through several years of unusually difficult operating budget decision-making processes. Unfortunately, I have to report that even though the national economy is clearly improving, the City of Newport News is facing another very austere operating budget environment for Fiscal Year 2011-2012.

The constraints, as we consider my recommended budget this year, are largely driven by a few readily understandable dynamics on both the revenue and expenditure sides. In terms of revenue, the two largest sources—real estate property taxes and transfers from the Commonwealth of Virginia—will both be down further in FY 2011–2012 as compared to the current year. This means that even with other local taxes steady or showing moderate growth, there is almost no new money to deploy. On the expenditure side, further cutbacks are increasingly difficult without dramatic impacts on service. The City has already taken many of the one-time, temporary, and personnel-reduction-type actions over the last three years that could be characterized by some as relatively easy to achieve.

Reductions in organizational infrastructure such as technology and vehicle purchases will have to be reversed in future years. Similarly, we cannot sustain reduced expenditures in street rehabilitation without an unacceptable decline in the quality of our public street system. Combined with expenditure increases that are mostly uncontrollable in the near term, such as energy costs and prudent contributions to our pension system, there are no more obvious reductions like hiring freezes, personnel attrition, and line item trimming tactics that can be used to make the arithmetic of our budget work. Our employees have been asked to do more with less and covered for positions that have been eliminated over the

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past three fiscal years. For the most part, we have achieved efficiencies through staff reductions, but due to the law of diminishing returns, further staff cuts in most cases will be counterproductive unless we are prepared to eliminate a specific service or program. An equally unacceptable alternative at this point in the national economic recovery would be a real estate tax increase.

As gloomy as our budget environment continues to be, we recognize that our local economy is relatively strong, as is the City's tax base and organizational capacity to deal with financial challenges. In this context, we set out to build a recommended operating budget that achieves certain limited objectives within certain broad parameters. On the revenue side, we have once again prepared a budget with a minimum of tax and fee increases. On the expenditure side, our priorities are to restore the prior funding reductions to local education funding as much as possible, meet our long-term commitments in terms of debt service and pension contributions, begin to align our operating budget with the City Council-endorsed Strategic 8 Priorities, and seek to fund a modest general salary increase for our excellent workforce after 36 months with no pay raises. I believe my recommended budget is consistent with these priorities.

### OVERVIEW

I am submitting a budget to you that for the most part maintains the basic services that citizens expect of the City of Newport News. There are limited new initiatives, and funding startup costs for larger projects that will come to be operational or are needed to meet necessary services or address aspects of our Strategic 8 Priorities. I have been able to maintain most of the services and programs that are highly valued and demanded by our citizens.

My total Recommended FY 2012 Operating Budget is \$746,008,958, which is an increase of \$1.4 million or 0.19% over the current fiscal year. This total budget amount includes the General Fund, Schools, Public Utilities, and all Special Revenue and Trust Funds. This is the first budgetary increase in operating funds since the recession started in September 2008.

Of this total budget amount, the FY 2012 Recommended General Fund Operating Budget totals \$413,733,000, which is a \$2.7 million or 0.67% increase over the adopted FY 2011 Operating Budget. No adjustments in locally controlled tax rates such as real estate, personal property, machinery and tools, meals or lodging are being proposed. An increase of \$0.10 is recommended in a specific consumer tax, the Cigarette Tax. Real estate property assessments, which are based on market values established for the 12-month period of July 1, 2009 to June 30, 2010, will be expected to decrease for the second consecutive fiscal year.

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The initial estimate on the assessment decrease is an average of 2%, and therefore some property owners will be paying less tax in FY 2012. To put this in perspective, this percentage decline in assessments equates to a \$5 million loss from the City's single largest revenue source.

This is now the third fiscal year that General Fund Revenues (real estate taxes and revenue from the State) are projected to decline. The FY 2009 Operating Budget was built as the recession began, with optimism that the depth and length of the fiscal crisis would be shallow and brief; however, that budget had to be reduced by \$13 million mid-year to meet falling revenue estimates. The FY 2010 budget took into consideration the declining revenue sources for locally generated revenue. In addition, the Commonwealth of Virginia instituted a second round of permanent State revenue reductions. From the FY 2009 budget to the FY 2011 budget, General Fund revenues have shrunk over \$22 million or 5.1%. The FY 2012 Recommended General Fund Budget is still \$1.8 million less than the adopted FY 2008 budget of \$415 million.

There is some limited good news in local tax revenue performance. Due to increased levy values, personal property tax receipts are projecting higher for FY 2012 than was anticipated for the current fiscal year. Machinery and Tools Taxes are also showing a good performance with a \$1.2 million increase, bringing the estimate to \$16.3 million. Consumer-sensitive revenues of sales, meals, and lodging tax have been showing sustainable growth in the current fiscal year with sufficient consistency month to month to budget \$1 million more in these combined revenue sources for FY 2012.

Shortly before my submission of this recommended budget, the State General Assembly adopted a revised 2011-2012 biennial budget, addressing State revenue forecasts for the second year of the biennium. The full implications of the restored State funding were not known at the time of the finalization of this budget. I will keep you informed during your deliberation process of any changes in the revenue forecast that could affect the overall bottom line of this budget.

#### EXPENDITURE CHANGES

In order to meet the reduced revenue picture, I instructed my Management Team in September 2010 to review all of their departmental operations and provide me with suggested reductions that would maximize core functions, reduce or eliminate non-essential operations, and reorganize staffing to accommodate the highest priority work load. The target reduction for all departments was five (5) percent. To achieve this magnitude of cuts, severe service reductions and

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program eliminations would have been experienced. While I was able to avoid that magnitude of cuts through careful consideration of each line item, nearly every department did sustain some level of reductions in operations. However, in some cases, prior fiscal year reductions proved to be too deep, and fundamental functions and costs were not being covered in the available budget. As such, those few areas received increased funding. The departmental reductions and other changes are summarized in the budget document itself under the blue expenditure tab labeled *Expenditures*.

There are five general areas where this recommended budget is increasing over the current fiscal year: pension contributions, health care premiums, fuel and other energy costs, local contributions to the School Division, and of equal importance, for the first time in three fiscal years, an employee salary adjustment.

Pension Contributions

We have embraced a long-term, major strategy to strengthen our pension system. We are committed to an eight-year obligation that will incrementally increase the City's contribution to the Annual Required Contribution (ARC) to the Pension Fund. As a fundamental expense of our operating budget, this recommended budget includes a substantial increase in our annual and sustainable contribution to the pension system. I recommend our contribution increase from approximately \$22 million to \$26 million annually City-wide. This is consistent with our planned commitment to completely restore the actuarial position of our pension fund over time. The recommended contribution brings the ARC up to 59% from 54%, and represents a significant achievement. As a note, the School Division is a separate but important participant in this pension funding process and has budgeted for the same percentage increase in the Superintendent's recommended budget.

Health Care Costs

Health care costs are continuing to rise, and in order to maintain the ratio of 75% City/25% employee contribution toward the total premium cost we have had to increase funding for this item by almost \$1.5 million for the upcoming fiscal year. This continues to be an important benefit for our employees, more so than in past fiscal years when no pay increases were provided. In addition, it remains a strong recruiting tool and acts as additional leverage for soliciting qualified candidates as the City is now in the Virginia Retirement System (VRS) with other localities for newly hired employees.

Increased Energy Prices

There is an increased cost for vehicle fuel, which is an important part of our operations. With prices trending upward, we have increased our price-per-

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gallon estimate from \$2.72 to \$3.05, representing a 12% increase. In the General Fund, this equates to a \$340,892 increase. As a reminder, the City does not pay taxes on gasoline and our price per gallon is, therefore, less than the price at the pumps. It remains to be seen what the total impact on fuel prices related to Middle East political unrest and events in Japan will have in the upcoming year. In addition, Dominion Virginia Power announced an intended rate increase of approximately 17%. As a member of a municipal government consortium, we have a rate contract effective January 2011, and may not feel the full impact of this change. We anticipated a rate increase on our current contract of 4%, which added an additional \$71,000 in power costs. We may need to change these rate forecasts for both vehicle fuel and electrical power closer to the final budget reconciliation for FY 2012.

Contribution to Schools

Determining the level of funding for public education is an important part of the budget process and is the most significant expenditure category in the annual operating budget. State policy requires local governments to contribute a minimum level of funding to Schools, which is determined by a Composite Index based on a jurisdiction's ability to pay. Accordingly, the City of Newport News is required to contribute \$47.5 million to Newport News Public Schools for FY 2012. Most informed observers view that number as wholly inadequate. I am recommending a contribution of \$112.2 million, which is a \$3 million or 2.7% increase over the current fiscal year. The FY 2012 contribution includes \$12.4 million in City funding for Schools' debt service.

It should be noted that the City maintained level funding to Newport News Public Schools at \$113 million level for two fiscal years, before reducing the contribution by \$4 million in the current fiscal year. Some neighboring localities reduced funding to their school systems by significant amounts during the same time frame. As a note of caution, when comparing our General Fund support to Schools with our immediately contiguous neighbors of Hampton, York County, and Williamsburg-James City County, only Hampton includes annual debt service support in their published amounts. When additional debt service amounts are taken into account, our Public School investment is significant, but not in any way disproportionate.

Employee Compensation and Benefits

My recommended operating budget includes funding for a general across-the-board salary increase for City employees. By July 1, 2011, City employees will have worked for 36 continuous months without any sustained general salary adjustments. I think we all recognize the personal strain this has put on our excellent workforce. I wish to recognize City employees' dedication even during this time of fiscal stress. Therefore, I am recommending that all employees

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receive a two (2) percent salary adjustment, effective July 1. The cost of this salary adjustment is \$2.6 million. While the expenditure reductions that I have noted above were difficult to make, attaining this goal of a salary adjustment for employees was fundamental in developing this budget. I could not continue to ask employees to yet again do more with less, and not at least partially compensate employees for their increased work load. In addition, as described in the next section, there will be an increase in employee out-of-pocket health insurance costs in the upcoming fiscal year.

Increases in health insurance premiums have unfortunately become part of the expenditure operating challenge for the City every year. The annual increase is generally based on the prior year claims and services provided to our employees. The current operating budget was built on the City's absorbing the employee's share of a 10% premium increase from January 2010 through June 2011. As a particular note of good news, through careful plan management and lower experience costs, the premium increase was only 2%. In July 2011, employees will be responsible for this premium increase. As our contract is based on a calendar year, employees will be faced with yet another increase in January 2012. If we continue forward with the same experience, we are anticipating a 5% premium increase at that time, and we have budgeted for such a level.

To be able to fund these five expansion areas, the FY 2012 Recommended Budget reflects reductions in most other operational expenses. There are few enhancements based on contractual circumstances or specific needs. As expected, to meet falling revenues it was necessary to reduce service levels in some areas, which are detailed below.

REDUCTION IN FORCE, REDIRECTED STAFFING

My approach in preparing this budget has been to work to minimize layoffs. Exceptions to this are where the operational cost of a function is clearly no longer cost effective for the City. It is in those instances where I have found it necessary to recommend the elimination of positions. I am recommending a reduction of ten (10) positions in the General Fund, and the elimination of five (5) positions in the Solid Waste Fund. Of these 15 total positions, unfortunately six (6) are currently filled. This is relatively small compared to the number of positions eliminated in previous fiscal years. Since FY 20009, 212 positions have been eliminated in the General Fund and 36 in other operating funds.

The eliminated positions for FY 2012 are detailed below:

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**General Fund Position Reductions**

<u>Category</u>	<u>Filled</u>	<u>Vacant</u>	<u>TOTAL</u>
Front Line	1	0	1
Management	0	1	1
Professional	4	2	6
Support/Clerical	1	1	2
<b>TOTAL</b>	<b>6</b>	<b>4</b>	<b>10</b>

Because of the selective hiring freeze that we have had in effect since the fall of 2009, we have been able to eliminate many resulting vacant positions. The majority of the expenditure reductions are from related salary and fringe benefits reductions and balances this budget. As a reminder, the City has an established Reduction-In-Force (RIF) policy that created the standard that any employee who would lose their current position due to a reduction-in-force, would have the opportunity to apply for and, if qualified, be placed in vacant positions over other applicants. I am currently holding open several vacancies in order to allow for a greater range of possibilities for any such affected employee. Given the size and scope of the various positions that the City has available, I hope that most of the individuals affected by the RIF have the opportunity to find different employment with the City.

I want to caution that I believe that we have reached the point where we cannot eliminate any other positions without the elimination of programs, services, or other City functions. The current workforce has been assuming the responsibilities of the eliminated positions over the past three years with no relief in the workload burden. From this point forward, an eliminated position will need to be associated with a specific service to either our citizens or our internal City users that will be forgone.

In preparing this budget, in addition to trying to minimize layoffs, we also continue to place a great deal of emphasis on public safety. I am not recommending the elimination of any filled uniformed public safety positions that have direct citizen service contact. However, I am recommending the elimination of one (1) management level position, a vacant Police Captain position. By eliminating this one position, I was able to use this salary and fringe benefits savings to assist in funding the seven (7) Police Officer positions that we have had the allotments for, but I was unable to fund due to budget constraints in the current fiscal year. Fully funding these seven positions will allow for more sworn police officers providing direct citizen services. For the Fire Department, in preparation for the opening of the new replacement Fire Station #3 in the

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Brentwood section of the City, I approved the establishment of twelve (12) new Firefighter/Medic positions in the current year. Those positions will be fully funded for the first time in the FY 2012 budget. And finally in Juvenile Services, the Department continues to reorganize positions to more efficiently and effectively operate. This reorganization includes the elimination of funding for one (1) management level position of Assistant Director, while retaining the position allotment. Based on a FY 2010/2011 consultant study recommending additional Juvenile Services Counselor positions, I am recommending that the Department add two (2) Juvenile Services Counselor positions. Funding for these positions is offset by the Assistant Director funding reduction mentioned above. I remain committed to ensuring the basic safety of our citizens. After City Council input and in the final reconciliation of revenues, restoring some funding in the Public Safety category is one of the important elements to be considered.

Additionally, after careful consideration I am recommending that a limited number of other new positions be added to the budget in the upcoming fiscal year. In the User Fee funds of Wastewater and Stormwater Management, I am recommending that a total of ten (10) new positions be added. The Federally mandated regional sanitary sewer evaluation and repair consent order continues to be a major factor in increasing costs; these funds will require the new positions to cope with continually increasing demands. The positions include:

- an Operations Superintendent to share oversight of 17 work crews;
- a Maintenance Specialist and a Maintenance Mechanic II to implement and maintain the new valve maintenance program;
- an Instrumentation/Control Specialist and an Electrician to more effectively maintain 183 pump stations and associated equipment;
- an Inflow Infiltration Technician and an Equipment Operator to perform increased flow monitoring work;
- an Engineer III to perform additional Consent Order engineering work; and
- a GIS Programmer Analyst and Environmental Specialist that are necessary in anticipation of two new State mandated programs that are tentatively slated to begin in FY 2013.

The only other non-Public Safety General Fund position that I am adding is a Digital Services and Branch Manager Librarian. This position will be converted from a current part-time slot, and will be responsible for overseeing the integrated library system, VITRUA, for the computer lab curriculum, and the Library system's webpage and social media management, among other duties.

#### SERVICE IMPACTS - REDUCTIONS

The recommended budget reflects a deliberate effort to minimize impacts on service delivery to our citizens. Newport News continues to have an exceptionally robust range of services, which is an important quality-of-life consideration for retaining current residents and attracting new citizens. However, there are some areas where reductions in service levels are necessary.

For several reasons, I am recommending altering the once-a-week curbside bulk waste collection program in Public Works. Instead, I am recommending a bi-weekly bulk waste collection that will occur on the resident's recycling day. First and most simply, few if any residents routinely place bulk waste items on the curb for weekly collection. However, at this time we routinely send our large knuckleboom trucks on the standard collection routes throughout the City. This present use places continuous stress on the lifespan of the vehicles, consumes fuel with a lesser return on payload, and requires a certain level of staffing to cover all areas of the City. This is a perfect candidate to be addressed both in our Sustainability and Operational Efficiency Priorities. By moving to a bi-weekly collection, we will better match the behavior patterns of the citizens, and still be responsive to "peak periods" of bulk waste activity (e.g., spring and fall cleanup periods). In addition, we will be able to reduce five (5) positions through attrition and avoid the replacement of six (6) costly bulk waste trucks.

Most importantly, this change allows us to make only a moderate increase in our Residential Solid Waste Fee of \$0.27 per week, equating to \$14.04 per household annually. Without this increase, we would be required to draw down on our Solid Waste Fund reserves to a level in which we would not be able to minimize future rate increases. A decision to continue this service at its present weekly collection level would also require an additional investment in expensive replacement equipment; and we would have no choice then but to raise the Residential Solid Waste Fee even higher. This additional rate increase pressure was the determining factor in recommending elimination of this service.

In the Libraries and Information Services Department, I have made the difficult decision to eliminate the Bookmobile Service. Elimination of this Library function will result in the reduction of two (2) Information Services Specialist positions and a savings of approximately \$120,000. In addition, the present Bookmobile, which was purchased in 1995, will within two years reach the reasonable lifespan of the vehicle. In today's dollars, a modest replacement cost with limited customization is estimated in the range of \$200,000.

The amount of funding for the annual vehicle replacement program, information technology equipment and infrastructure, and street maintenance continues to be

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funded at a much-reduced level in this operating budget recommendation. It was a hard choice to continue to underfund these aspects of our operations for a fourth consecutive fiscal year. We have managed to address some of the street repair issues through Federal stimulus funds; this was clearly one-time money that we will not be able to access in the future. Though while I believe that we can withstand this continued level of low funding in FY 2012, it will be one of the first areas that I would choose to restore if our revenue estimates improve. It is critical that in FY 2013 we make major steps to restore funding over time in these areas.

Parks, Recreation and Tourism functions is another area that is impacted by this recommended budget. Funding for events programming at the Downing Gross Cultural Arts Center was reduced by \$35,500, with no anticipated changes to the performance schedules or offerings, but rather to match dollars with actual program expenditures. Termination of the Farmers Market operation will generate \$95,924 of expenditure savings and includes the elimination of one (1) full-time position. Minimal funding will be retained for utilities and some maintenance to keep the facility available for one-time events. It is important to take initial steps now in preparing for this property to become a pivotal element in another one of our Strategic 8 Priorities, Southeast Redevelopment. This facility is part of the several block tract of land that is part of the exciting plan for substantial private investment, through infrastructure, land, and public safety improvements. In other reductions, I have recommended that Special Event Funding be reduced by \$117,731. This reduction will not eliminate or change any other current events, functions, or offerings. Rather, it requires the use of the Special Events fund balance reserves to fully fund the amount needed to maintain these events that our citizens enjoy and that enhance this City's quality of life.

#### SERVICE IMPACTS - ENHANCEMENTS

There clearly have been limited operating funds for some time in our budget with little, if any, money that could be considered discretionary. However, there are upcoming obligations that must be started now in order to be in place for when projects or initiatives are completed during the new fiscal year. As with the five general City-wide cost increases, in order to fund the components listed below, reductions were incurred in other expenses throughout the budget.

Initial funding for Stoney Run Community Center has been added to the Parks, Recreation, and Tourism budget for partial-year operation of the new recreation center in the amount of \$139,594. This amount will allow for last quarter funding

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for potentially four positions to staff the center in preparation for the opening and initial operations, should construction be favorably accelerated.

For the next steps in addressing the Customer Service Strategic Priority through the establishment of a 311 Call Center operation, I have created initial funding in the Information Technology Department's budget. A portion of the vacant Project Manager A's (311 Call Center) salary and fringe benefits costs was reduced (\$64,378), postponing the hiring of this position until the fourth quarter of FY 2012. This time frame is more in line with the projected completion and start-up of a City-wide 311 Call Center function. In turn, I have dedicated a portion of this reduction to contractual services funding, with the intention of using consultant services in assisting us in the final determination of the appropriate customer call routing software and hardware configurations, and staffing as the plan comes to completion.

With the view to moving existing like City functions into a central location, \$75,000 is budgeted for the South Morrison School Re-Use program. This will provide partial year funding for utilities and facility maintenance, as we work to finalize the details on consolidating Police Central Precinct Community Resource Officers, Schools' Jackson Academy (drop out recovery) operations, and Partnership for Youth activities.

I feel there is a critical need to fund a certain element of our safety net services to our citizens that continue to feel the economic pressures in an area that the State's responsibilities are again withdrawn. The Peninsula Health Department's State Cooperative Budget Request was based on the premise that the Peninsula Health District will receive reduced State funding for FY 2012, increased contractual services for lease costs, and no wage increase anticipated to be given to State employees. In addition, it is anticipated that there will be no change in revenues from patient paid fees over the current year's estimate. Therefore, the Local Share Match based on the proposed Health Department State Budget request is \$1,870,559. This is a reduction from the current year of \$174,729, or 8.5%, less than the current budgeted amount of \$2,045,288.

With continued reduced State revenue to the Health Department, I have recommended that \$120,000 be budgeted in FY 2012 to support the Adult Services Dental Clinic program. The Dental Clinic is a non-mandated function for the Health Department. For FY 2010, 1,449 patients had 1,975 visits to the Clinic, with 94% or 1,362 of the patients Newport News residents. This City amount will contractually fund 35% of the salary and fringe benefits cost of two dentist positions, and 100% of a dental technician cost. This function would be 100% City cost, and not refundable through the State reimbursement process. As the State continues to reduce funding to the Peninsula Health District, Dental

Services as a non-mandated function, would be eliminated by the end of the current fiscal year. By providing this annual support, this service would be retained.

#### OTHER OPERATING AREAS

##### Debt Service and Cash Capital

General Fund support for the City's Debt Service will be \$34,343,242 in FY 2012. This figure includes payments for outstanding General Obligation Debt, Airport Debt Service of \$545,875, and new bond issue costs. The recommended budget assumes a General Obligation bond issuance during FY 2012. This amount is slightly over \$1 million or 2.9% less than the current fiscal year. Through cash flow management and reduced capital improvement projects, we have been able to stretch our bond cash for nearly two fiscal years. The City last sold \$30,000,000 of General Obligation General Improvement Bonds in April 2009 to support our ongoing capital improvements program.

Cash Capital, a component of the City's adopted Capital Financing and Debt Management Policies, is budgeted at \$2,894,246. I intend to use the Special Projects Fund to supplement that amount in order to reach our 20% cash capital goal for FY 2012, which is \$6,385,000. Cash Capital allows for current operating funds to be used to fund less expensive and more regular capital investments (e.g., roof and HVAC replacements, and capital equipment) to decrease reliance on bond cash for shorter term capital projects.

##### Community Support and Regional Organizations

My recommended funding for the thirty-two (32) Community Support agencies that are supported by City funding is \$2,265,652. The funding for the Regional Organizations that the City is a member or participant of is \$5,592,803. The FY 2012 combined Community Support and Regional Organizations amount is proposed at \$7,858,455. Taken as total comparison, this represents a reduction in the level funding of \$147,826 or 1.8% less than FY 2011.

Since FY 2010, the approach in formulating the Community Support and Regional Organizations recommendation has been to identify opportunities to reduce the total level of grant awards while maintaining level funding for organizations that provide necessary human services to our citizens. For those organizations that focus on arts, culture, tourism, youth education and other miscellaneous activities (that do not fit within one of these categories), a 5% reduction was taken. For one agency in the youth education group, the Virginia Scholarship and Youth Development program, funding was totally eliminated. For those agencies that provide either emergency relief services or aid in some manner or for those that provide military services, level funding was maintained.

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One Community Support activity, the Peninsula Foster Grandparents program, has been moved to this section of the operating budget. This program has been funded from the Human Services Department annual budget and has been moved to Community Support to better reflect the nature of the expense. With these suggested changes, the net total reduction for the Community Support Agencies is \$71,352 from the FY 2011 budget.

Regional Organizational Agencies are those where most of the City's contributions are based on a contractual agreement or a per capita support level. Funding for this group of activities, for the most part, remained at the FY 2011 level. There are two exceptions. First is Hampton Roads Transit (HRT). With a requested increase in funding of \$503,359, this would have brought our FY 2012 support to HRT to \$4,707,385, which is a 12% increase. I have recommended level funding at this point, directing that we consider both reducing and eliminating routes that have limited ridership or using our accumulated reserves with HRT. This will allow us to manage our increase to a more acceptable level. I have directed staff to work with HRT in the ensuing weeks prior to final budget adoption to return with a plan for FY 2012. The second exception is funding for the Hampton-Newport News Criminal Justice Agency (HNNCJA). Funding in the amount of \$80,477 has been eliminated in the upcoming year; the Agency is not requesting funding for FY 2012, as it is receiving office space from the City in lieu of support. Funding for the Hampton Roads Planning District Commission (HRPDC) is currently listed as level with FY 2011. In its initial request to the City, HRPDC's amount, which is based on a per capita formula, used census data from prior to the 2010 Census. Currently HRPDC is reviewing all available census data for the region, prior to revising its budgetary request. Funding for Thomas Nelson Community College and separate funding for the Thomas Nelson Community College Workforce Development program have been moved from the Nondepartmental section of the operating budget to Regional Support to better reflect the nature of the expenses. With these suggested changes, the net total reduction for the Regional Organizations is \$76,474 from the FY 2011 budget.

Additionally, there were a total of seven (7) agencies not funded in the current year that solicited support from the City for \$423,767 in requests. Some of these agencies were requesting restoration of funds that were eliminated in prior operating budgets, and some agencies were new requests. It was difficult to consider any new initiatives in such a challenging budget year, while at the same time reducing funding to existing agencies that continue to provide important ancillary services to our citizens. I am not recommending any additional agencies be funded in FY 2012.

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RATES AND FEE INCREASES

I have kept fees at their current levels where possible and have proposed only one modest tax increase, and one user fee change. For the one tax increase, I am recommending that a highly specific user fee, the Cigarette Tax, be increased by \$0.10, from \$0.65 per pack of 20 cigarettes to \$0.75. Based on a current revenue base of approximately \$4 million, the new anticipated revenue is \$500,000. This rate has not been increased since FY 2003.

For the Solid Waste User Fee, the recommended weekly rate increase for a standard, 90-gallon container that most residential households use will be \$0.27. This equates to \$14.04 per year per single family residence. As part of the additional income generated by this rate increase, contractual funding for Community Maintenance city-wide neighborhood cleanup projects and other sites can be started in FY 2012.

Separately, I am recommending that the Water Rate structure be changed. The new rate structure being recommended eliminates the summer consumption rate, increases monthly/bimonthly meter fees to better reflect the cost of service based on meter hydraulic capacity ratios, implements a conservation rate (Block 3) for single-family residential customers when using excessive amounts of water, and implements a second tier in the industrial rate to reflect reduced cost to provide water to heavy industrial users. The following water consumption rates are being proposed for FY 2012:

Fee	Current Rate	Proposed Rate
<i>Single-Family Residential</i>		
<i>Bimonthly</i>	Lifeline (0 to 6 HCF) \$2.78/HCF Above 6 HCF \$3.19/HCF	<b>Lifeline (0 to 6 HCF) \$2.89/HCF</b> <b>Normal Use (Greater than 6 to 50 HCF) \$3.32/HCF</b> <b>Conservation Tier (Greater than 50 HCF) \$6.64/HCF</b>
<i>Industrial Monthly</i>		
Tier 1 (0 to 40,000 HCF)	\$3.19/HCF	<b>\$3.32/HCF</b>
Tier 2 (Greater than 40,000 HCF)	\$3.19/HCF	<b>\$2.89/HCF</b>
<i>General (All Other Consumption)</i>	\$3.19/HCF	<b>\$3.32/HCF</b>
<i>Monthly/Bimonthly</i>		
<i>Summer Conservation Rate</i>	\$0.61/HCF	<b>Eliminated</b>

In addition, the meter charge will be increased based on the size of the meter. We are able to hold this increase down by reducing operating expenses in Waterworks, holding positions vacant, and using some retained earnings. This proposed rate increase reflects a rise in some actual Waterworks costs, as well as

a sustained demand reduction. By adopting the modified water rate structure and increased meter fees for the upcoming fiscal year, it will preclude us from having to implement a larger use of reserves and rate increases in the future based on the present usage block structure. Additionally, it is important to note that this is the first time the Life Line rate of \$2.78 for the first 600 cubic feet (HCF) is being increased since it was established.

### MOVING FORWARD

Looking forward beyond the next fiscal year, there are certain trends and highly likely scenarios that we should be anticipating to the extent possible. Some of our ongoing organizational and community commitments can also be projected forward with some degree of clarity.

Over the next several years, the economic conditions that set the parameters of the City's fiscal environment are likely to be characterized by slow growth. Real estate values should stabilize and cuts from the State should level off as the Commonwealth's income-tax-driven budget gradually improves. However, dynamic revenue increases from either real estate or State programs are unlikely. Local taxes should grow modestly, but downward pressure on national government spending suggests a decline in Federal funding for schools, homeland security and public safety, social safety net programs as well as negative impacts on our regional economy, which remains overly dependent on Federal spending. While no one can foresee the future, these macro economic trends suggest that this community will largely be on its own with the region to manage its fiscal challenges, meet its commitments, and take advantage of opportunities which arise.

The trends described above can also be translated into more specific financial parameters we would be foolish not to anticipate in the coming years. Examples of these parameters include the need to continue efforts to constrain City debt where we are making good progress. Another very real parameter will be the need to cover the growing cost of employee and retiree benefits and salaries. Our pension reforms will begin to improve the long term picture within a few years, but we must continue to increase our annual investment in the pension system for some time to come. The cost of health care both for active employees and especially for retirees continues to grow. We do not yet understand the implications of national health care reform. However, if as an organization we do not begin to see some slowing in the cost growth of health care in the near future, the City may be forced to revisit our ability to provide for employees and retirees at current levels. Current challenges in the area of employee and retiree compensation will be exacerbated by the demographics of our workforce. Many

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knowledgeable and well trained people will likely retire within five years. Not only will it be necessary to provide competitive compensation for their replacements in a tightening labor market, but their departure will put greater pressure on our retiree benefits at the very same time.

Fortunately, in terms of the City's financial integrity, we have been far sighted in establishing many fee and enterprise-based funding strategies over the years for services such as water, sewer, stormwater, and solid waste. Looking forward, we must avoid the temptation to spend down our reserves. We should continue to run these fee-based operations as much like a business as possible. In particular, our stewardship of the regional Waterworks must be responsible and will require incremental fee increases, as well as sound management to ensure long-term viability. Similarly, driven by new Federal and State environmental regulations, we must anticipate substantial increases in Stormwater Management fees in the years to come, even though we have avoided any increase this year as we await clarification of the new regulatory requirements.

Moving forward, we must also look to our strategic initiatives as a guide in making judgments about where to invest our limited resources. Already in this year's recommended budget, we are suggesting line items and anticipating future operating costs for initiatives in such diverse areas as the new Stoney Run Community Center, which will be our flagship project related to the Upper Warwick Boulevard Corridor Initiative, a new 311 Center in support of our Customer Service strategy, a repurposing of our Solid Waste assets to build our Community Maintenance capacity, and the closure of the Farmers Market in conjunction with the public and private investments being channeled into the Lower Jefferson Avenue Corridor effort, to name a few.

In time the operating and capital impacts of our other Strategic 8 Priorities will become evident in both the operating and capital budgets of this City. While the work of our Operational Efficiency Committee is not yet complete, I am endorsing and recommending moving forward with the single most financially significant long-term suggestion to emerge from that process thus far. Specifically, effective July 1, 2012, I propose changing the Elderly and Disabled Tax Abatement program to a Tax Deferral program. This change over a number of years will reverse the growth of an over \$2 million loss of annual City revenue. The deferral would allow our financially challenged elderly and disabled citizens to receive the same practical benefit while living in this City (and still receiving the same services as other citizens), but would require the estate to pay deferred taxes to the City rather than asking all of our other citizens to cover the cost of City operations and essentially providing what could be considered a financial "gift" to selected families. By including the limited number of disabled citizens participating in the current program, it creates equity among all individuals and

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households that may have the need to seek some financial relief through real estate tax deferral. I am hopeful that City Council will enact this prospective program change as part of our budget decision-making process.

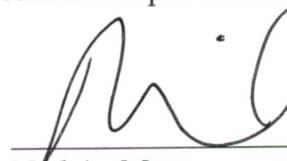
CONCLUSION

To summarize, I have submitted a balanced budget with a minimum of tax and fee increases. This budget achieves the minimal objectives that we can reasonably aspire to given all of the constraints we continue to face, while anticipating our future operating requirements to the extent possible. I chose to make sustainable reductions that fit within our known revenue streams; while the economy is still sluggish, there are signs that recovery is slowly occurring with hopes of better prospects in future fiscal years.

My staff at all levels, from management to front-line professionals, and I have worked very hard to develop a budget that is responsive to the current economic climate, while at the same time protects essential core services to the citizens of Newport News. I especially want to acknowledge Budget Director Lisa Cipriano and her knowledgeable staff for their diligence and dedication over the past several months as we worked to develop the Recommended FY 2012 Operating Budget.

While this memorandum highlights the budget in general, specific areas of interest will be detailed in Budget Position Papers, which will be delivered to you by April 1. The budget will be made available to the public on the City's web site and in all Newport News public libraries. We are also in the process of producing a NNTV program that will be the third in a series on City budget highlights and will contain the information in this memorandum. It will be available to the public in the immediate future.

I look forward to working with you and the citizens of Newport News as we finalize this budget through work sessions and public hearings.



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